

EXHIBIT 1  
DATE 1/23/09  
HB 2

## DEPARTMENT OF COMMERCE

### Board of Investments 2011 Biennium

Legislative Fiscal Division Budget Analysis, Page A-307

#### PROGRAM CONTACTS

The department, division, program director and chief financial officer for the department, division, program and their contact information are:

Title	Name	Phone Number	E-mail address
Executive Director	Carroll South	444-1285	<a href="mailto:csouth@mt.gov">csouth@mt.gov</a>
Deputy Director	Geri Burton	444-1365	<a href="mailto:gburton@mt.gov">gburton@mt.gov</a>
Chief Accountant	Gayle Moon	444-0099	<a href="mailto:gmoon@mt.gov">gmoon@mt.gov</a>
Chief Investment Officer	Clifford Sheets	444-0058	<a href="mailto:csheets@mt.gov">csheets@mt.gov</a>

#### WHAT THE DIVISION DOES

The Board of Investments manages the Unified Investment Program mandated by Article VIII, Section 13 of the Montana Constitution. Section 2-15-1808 created the Board of Investments and Section 17-6-201 gave the Board sole authority to invest state funds. The Board also invests local government funds at their discretion. The Board currently manages an investment portfolio with a market value of approximately \$11.5 billion. The Board manages the portfolio under the "prudent expert principle."

#### Funding:

The Board has two different funding sources, the first of which is an internal service type proprietary account for management of the Unified Investment. By law, the Board charges the accounts invested a fee for management services. The second is an enterprise type proprietary account funded by the "spread" between the interest rate on bonds issued in the INTERCAP Program and the interest rate charged to borrowers.

#### Mission:

To provide prudent investment management of state and local government funds; work with financial institutions, state agencies, and local governments to enhance and expand Montana's economy and assist new and expanding Montana businesses; and to lend low-interest funds to eligible governments for a variety of projects.

To meet these challenges, the Board of Investments is committed to employing proven, long term investment strategies and finding creative solutions to financial issues facing government entities and new and expanding businesses in the state.

#### Goals and Measurable Objectives

The following figure shows the division biennium goals and performance measures that are associated with the proposed 2011 biennium HB 576 budget.

Measurable Objectives for the 2009 Biennium		
Goal	Measurable Objectives	Current status of Measures
1.	To the extent that the financial markets permit, investment performance to exceed the 7.75% and 8.0% actuarial assumptions of the pension plans.	Ongoing.
2.	Achieve or exceed the median performance of the Board's pension fund peers.	Ongoing.
3.	The performance of each pension fund asset class should exceed the relevant benchmark.	Ongoing.
4.	Continue in a prudent manner to grow the In-State Investment Program.	Ongoing.

## **Statutory Authority**

Board of Investments' responsibilities are mandated primarily in Article VIII, Section 13 of the Montana Constitution, Title 2, Chapter 15, and Title 17, Chapters 5 and 6, MCA.

## **HOW SERVICES ARE PROVIDED**

The Unified Investment Program is managed by a combination of Board staff and external investment managers. The In-State Investment Program is managed by Board staff in cooperation with Montana lenders. The INTERCAP Program is managed by Board staff in cooperation with the bond Trustee and other members of the financial team. The Board markets the In-State Investment Program to Montana lenders and the INTERCAP Program to eligible Montana governmental agencies. The Unified Investment Program is not marketed but Local Government agencies are aware that they may invest in the Program. (34 FTE)

While there has been no program expansion, the Unified Investment Program continues to grow and become more complex as additional asset classes are added and more external investment managers are hired. The Unified Investment portfolio grew nearly \$1.76 billion from June 30, 2006 to June 30, 2008 – from \$10.65 billion to \$12.41 billion.

The growth and complexity of this portfolio require the assistance of consultants and additional financial research tools for Board investment staff. The consultants serve as an extension of Board staff by providing the expertise, resources, and services that the Board cannot provide internally, such as conducting Asset/Liability studies of the state pension plans, assisting with asset allocation, assisting with Requests for Proposal for external investment managers, and assisting in the selection of those managers. The research tools assist Board staff with investment decisions.

## **BUDGET AND POLICY ISSUES**

The following budget or policy issues are included in the division budget submission to the Governor's Office.

**Board of Investments HB 576 Decision Packages (Accounting Entity 06527 – Page A-310):**

**PL 7501 BOI Fixed Income Analytics Systems HB 576:** The Board manages a \$4.5 billion fixed income portfolio that includes all the state's major trusts, pensions, and the State Fund. The Board has never had access to

a fixed-income analytics system that permits a drill down to the security level to provide the type of information needed to assist in managing the portfolios. The Board has hired a new fixed income portfolio manager and plans to subscribe to an analytical system sometime in the fall of 2008. The annualized costs should be built into the 2011 biennium budget. Estimated annualized cost for this is \$150,000 per year and is funded from accounting entity 06527.

It is estimated that this decision package would impact assessments as follows:

	FY 2010	FY 2011
Requested-Fee Assessment	\$ 4,819,844	\$ 4,768,607
Decision Package Amount	\$ 150,000	\$ 150,000
Variance:	\$ 4,669,844	\$ 4,618,607

**PL 7502 BOI Administrative Costs Adjustments HB 576:** The total cost of this decision package is \$176,835 in FY 2010 and \$202,706 in FY 2011 and is funded from accounting entity 06527. Items requested include adjustments for overtime, Per Diem, rent adjustments, and indirect cost adjustments. The proposal would also provide for annualizing the costs of consulting and professional services fees.

It is estimated that this decision package would impact assessments as follows:

	FY 2010	FY 2011
Requested-Fee Assessment	\$ 4,819,844	\$ 4,768,607
Decision Package Amount	\$ 176,835	\$ 202,706
Variance:	\$ 4,643,009	\$ 4,565,901

The Bond program is funded entirely by an enterprise fund (accounting entity 06014). The legislature does not approve rates for this program and there are no direct appropriations provided in HB 2. The programs customers are outside of state government. The fee structures that is proposed does not materially vary from that proposed in the last session.

## SIGNIFICANT ISSUES EXPANDED

No significant issues requiring expanded justification were requested by the LFD.

## 2009 LEGISLATIVE FINANCE COMMITTEE PERFORMANCE MANAGEMENT INITIATIVE SUMMARY

As part of the 2009 Legislative Finance Committee's interim work plan, various workgroups met to discuss selected programs goals and progress towards specific measurable objectives, also referred to as performance measurements. It should be noted that some of the performance measurements were to be reached by June 30, 2009. The LFC interim project selected goals and related performance measurements and current status of the measurements are outlined below. A narrative discussion of the status of the measures (if any) is attached to the narrative section of this document.

The Board of Investments did not have any Legislative Finance Committee Performance Management Initiatives to report on in the 2009 biennium.

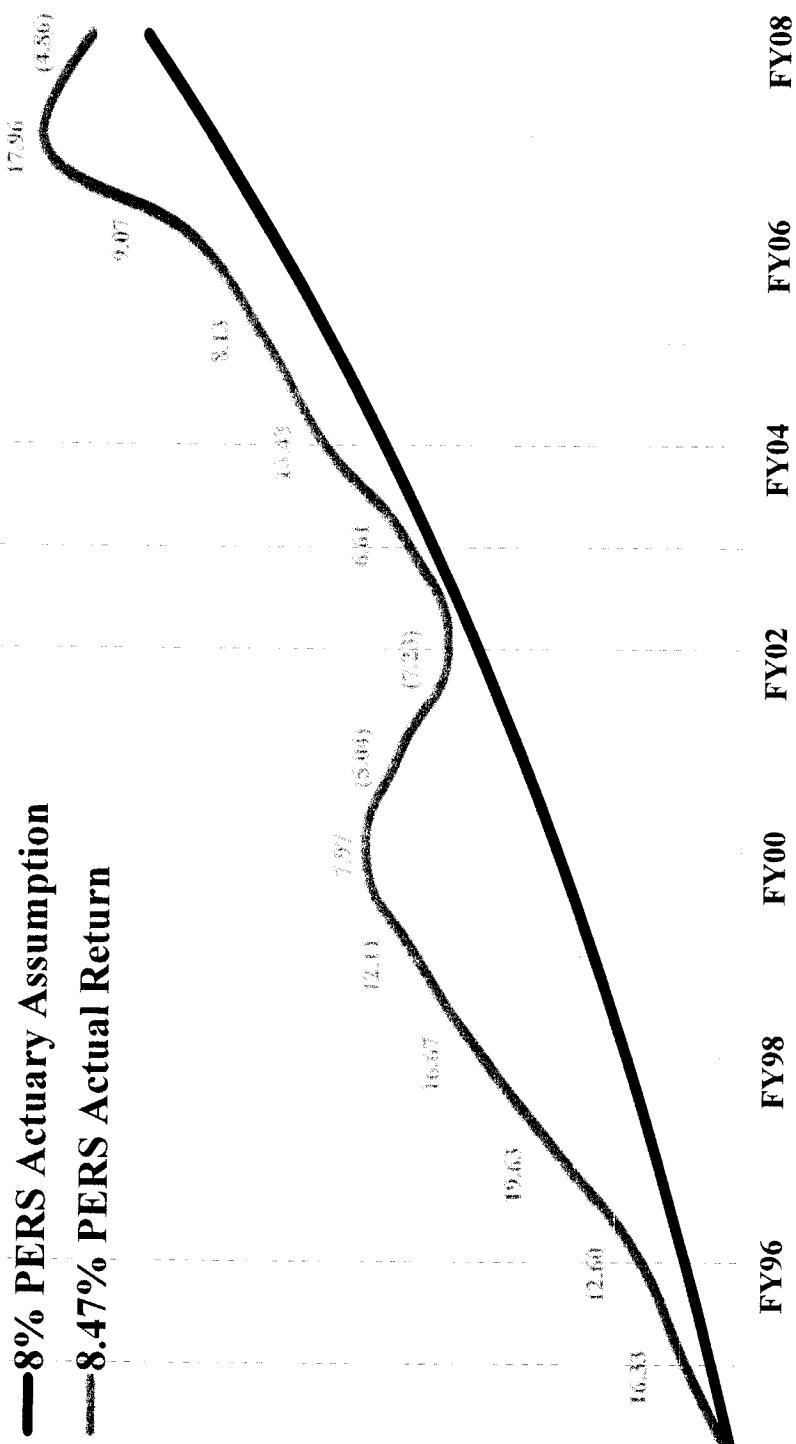
Pension Fund Investments  
House State Administration Committee  
January 15, 2009

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Presented by:  
Carroll South, Executive Director  
Montana Board of Investments

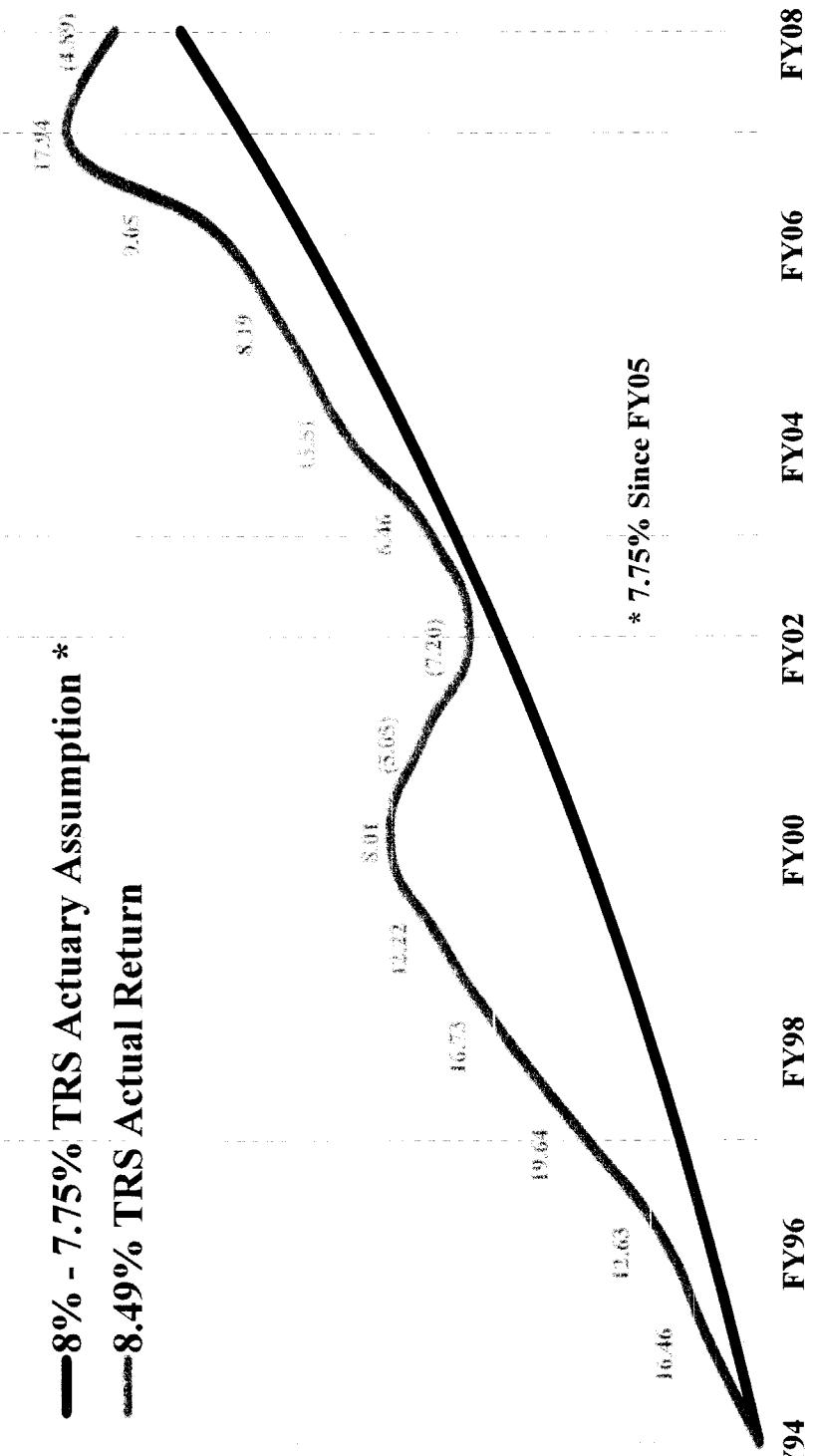
# PERS Returns Versus Assumption

— 8% PERS Actuary Assumption  
— 8.47% PERS Actual Return



# TRS Returns Versus Assumption

— 8% - 7.75% TRS Actuary Assumption \*  
— 8.49% TRS Actual Return



**Capital Markets Review**  
As of September 30, 2008

**Capital Markets Review**

**Third Quarter Environment**

In dramatic flight to quality and repricing of global investment risk, the credit and liquidity crisis gripped all markets during the third quarter and sent volatility skyward. In the quarter's final month, markets witnessed the largest bank bankruptcy in U.S. history and unprecedented market intervention by the Federal Reserve and U.S. Treasury. Fannie Mae and Freddie Mac were taken over by the government. Lehman Brothers filed for bankruptcy protection; the government took control of AIG for an \$85 billion loan. Merrill Lynch and Washington Mutual were sold, and Washington Mutual was seized by federal regulators. Lehman's bankruptcy on September 15 provided the catalyst for a late-quarter intensification of the credit crisis, as lending between banks ground to a halt and corporate borrowing costs soared for those corporations that could obtain credit at all. By the time a last-ditch effort on the part of U.S. regulators to secure passage of a rescue plan ultimately failed on September 29, the Dow suffered its largest one-point decline in history, before a 5% rebound on the quarter's last trading day. Concerns for global demand sent commodity prices, particularly oil (which declined 25%), downward.

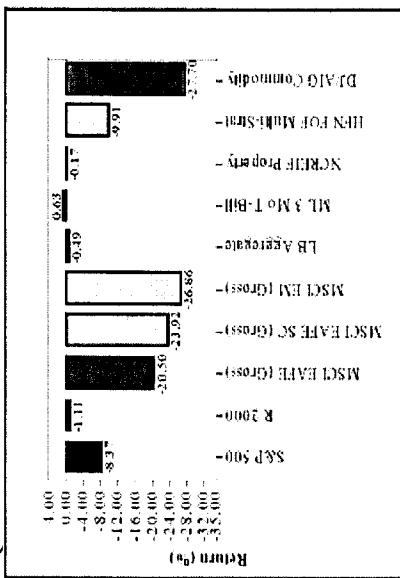
**Third Quarter Equities**

Markets around the world saw significant declines in the third quarter, based on a combination of a flight to quality given the credit and liquidity crisis, and on greater concerns of an economic slowdown. Commodity-rich and export-dependent emerging markets equities led the decline, returning -27%, in parity with the decline in commodity prices. International small-cap equities declined by 14%, and international developed markets fell by 21%. Within the domestic equity market, small-cap value securities provided the sole source of positive returns as every other market segment declined, led downward by large-cap growth. The economic sectors that had shown the most resiliency during the first half of the year saw the greatest declines in the third quarter, as energy and materials declined by 25% and 22%, respectively. Financial stocks, despite significant volatility, ended the quarter marginally positive, as the smaller and healthier banks posted gains. Consumer staples, long considered a recession hedge, posted the domestic market's greatest gains at 8%.

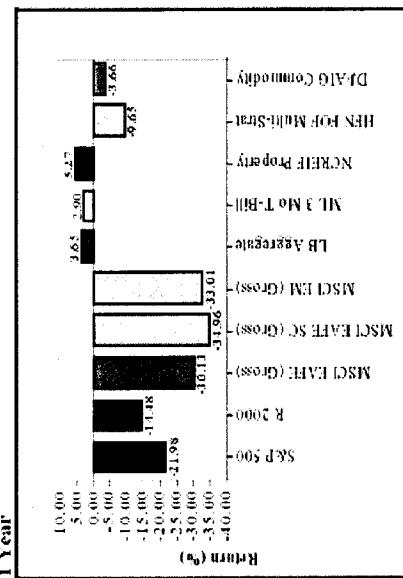
**Third Quarter Fixed Income**

In the quarter's flight to quality, every broad segment of the fixed income market except for short-term Treasury bills, fixed-rate mortgage-backed securities, and agency securities posted negative returns. Investors' preference for the very safest securities—short-term Treasuries, caused their prices to rise to such a level that several times toward the end of the quarter, their yields turned negative—indicating that investors were willing to accept a small known loss as the price of avoiding all uncertainty. At the same time, yields for any fixed income security that included default, interest rate, or any other risks soared as their prices collapsed. Longer-term Treasury securities saw a sell-off, partially because of fears that the \$700 billion in new debt expected to be issued by a government rescue plan would cause their prices to fall.

**1 Quarter**



**1 Year**



**Trailing-Period Performance**

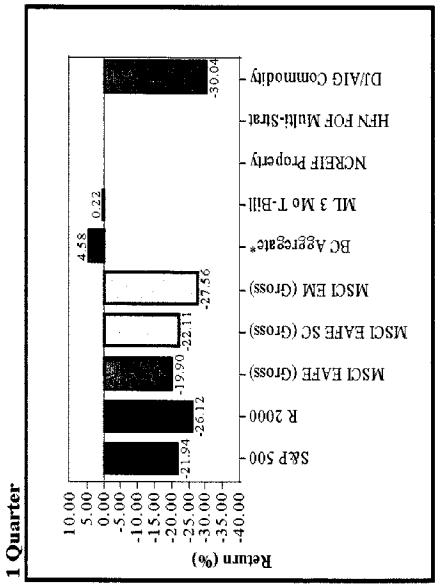
	1 Month	3 Months	1 Year	To Date	Year	1	3	5	10	Years
S&P 500	-1.4%	-6.7%	-19.3%	-21.7%	0.22	2.17	5.06	3.06	3.06	3.06
R 2000	3.70	3.61	-1.11	-16.35	-0.13	1.83	8.14	7.81	7.81	7.81
MSCI EAFE Gross	-1.03	-1.01	-1.32	-2.35	-0.15	1.58	10.16	5.12	5.12	5.12
MSCI EAFE SC (Gross)	-1.06	-1.03	-1.22	-2.37	-0.15	1.56	9.56	N/A	N/A	N/A
MSCI EM (Gross)	-1.03	-1.05	-1.39	-2.56	-0.15	1.69	19.05	14.77	14.77	14.77
LB Aggregate	0.06	0.95	-0.43	-0.49	0.03	3.65	4.15	3.78	5.30	5.30
ML 3 Mo T-Bill	0.16	0.15	0.30	0.63	1.83	2.90	3.26	3.35	3.35	3.35
NCREIF Property	N/A	N/A	-0.41	1.99	5.27	13.24	14.24	11.83	11.83	11.83
HFN FOF Multi-Strat	-1.50	-0.60	-0.50	-0.91	-0.52	2.81	4.81	8.03	8.03	8.03
DJIA (Commodity)	1.5%	2.1%	-1.1%	-1.1%	-0.31	1.86	1.86	1.86	1.86	1.86

Performance is annualized for periods greater than one year.

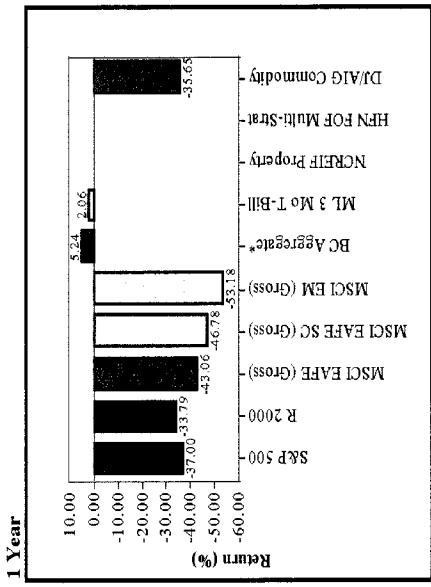
**Capital Markets Review  
As of December 31, 2008**

**Capital Markets Review**

**1 Quarter**



**1 Year**



**Trailing-Period Performance**

	1 Month Ending Oct 2008	1 Month Ending Nov 2008	1 Month Ending Dec 2008	1 Year To Date	1 Year	3 Years	5 Years	10 Years
S&P 500	-37.00%	-43.06%	-46.78%	-53.18%	-57.95%	-61.55%	-61.55%	-61.55%
R 2000	-33.79%	-43.06%	-46.78%	-53.18%	-57.95%	-61.55%	-61.55%	-61.55%
MSCI EAFE (Gross)	-4.42%	-5.80	-7.18	-8.45%	-9.75%	-10.35%	-10.35%	-10.35%
MSCI EAFE SC (Gross)	-2.03%	-3.43	-4.83	-5.93%	-7.03%	-7.62%	-7.62%	-7.62%
MSCI EM (Gross)	-4.41%	-6.85	-9.23	-10.72%	-12.11%	-13.74%	-13.74%	-13.74%
BC Aggregate*	-4.73%	-7.83	-9.92	-10.36%	-12.35%	-14.33%	-14.33%	-14.33%
ML 3 Mo T-Bill	-2.29%	3.25	3.73	4.38	5.24	5.51	5.63	5.63
NCREIF Property	0.10	0.91	0.22	2.06	2.06	3.25	3.25	3.25
HFN FOF Multi-Strat	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DJIAIG Commodity	-10.52%	-10.52%	-10.52%	-10.52%	-10.52%	-10.52%	-10.52%	-10.52%

Performance is annualized for periods greater than one year.

\*On November 3, 2008 Barclays Capital announced the re-branding of the Lehman Brothers indices.

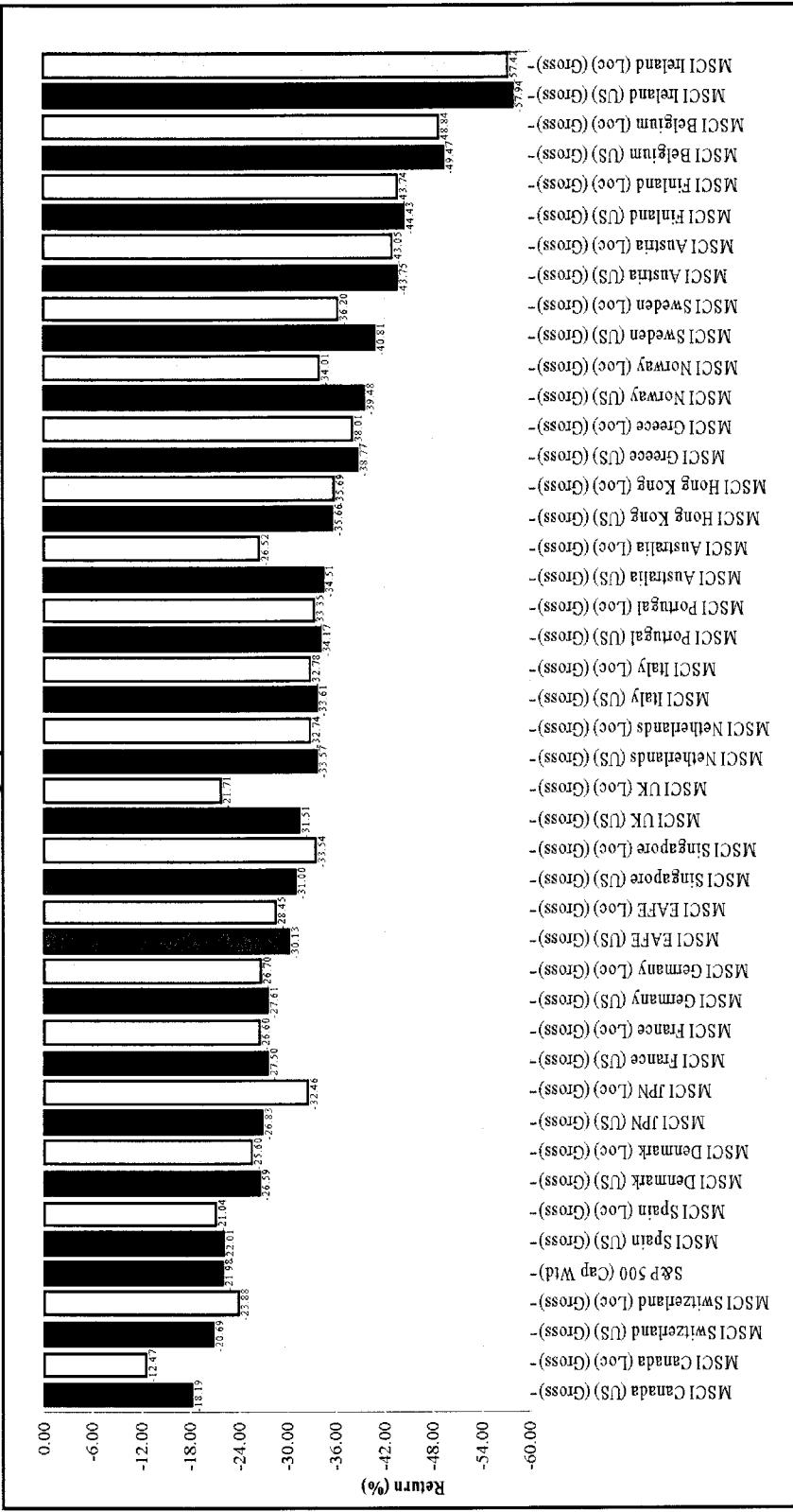
<sup>a</sup>All Lehman Brothers indices now reflect the Barclays Capital name.

**RV Kuhns**  
► & ASSOCIATES, INC.

# International Stock Performance

International Equity Market Performance  
As of September 30, 2008

1 Year Ending September 30, 2008



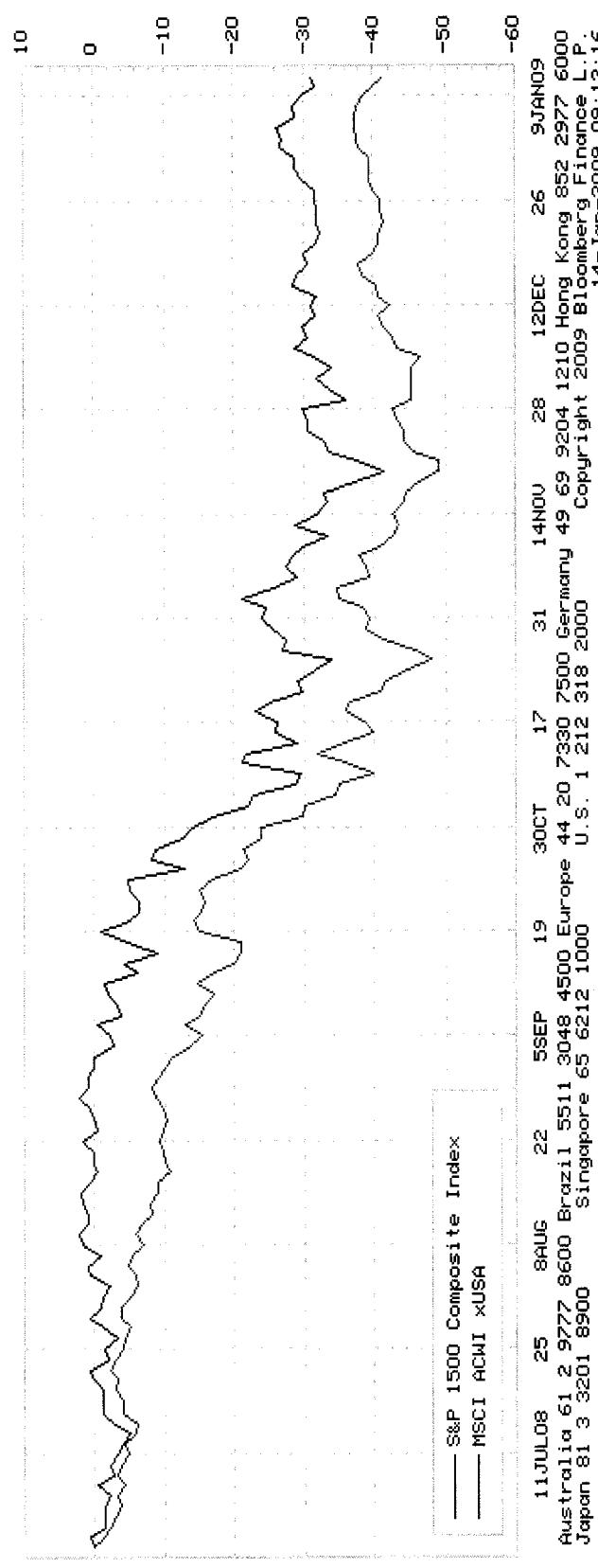
# Global Stock Index Performance

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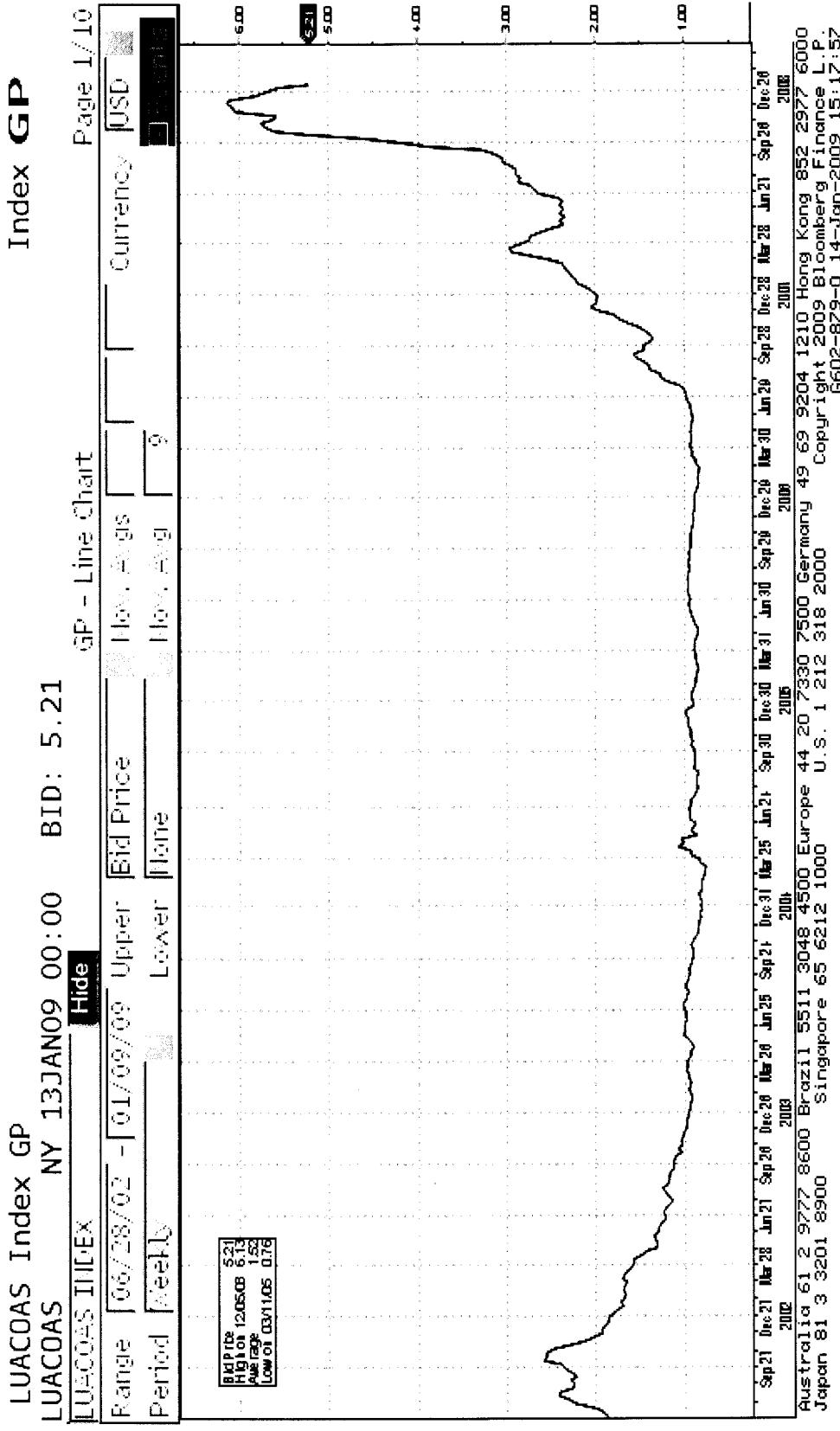
Hit 1<GO> for Options, Hit <Page> for table.

## COMPARATIVE RETURNS

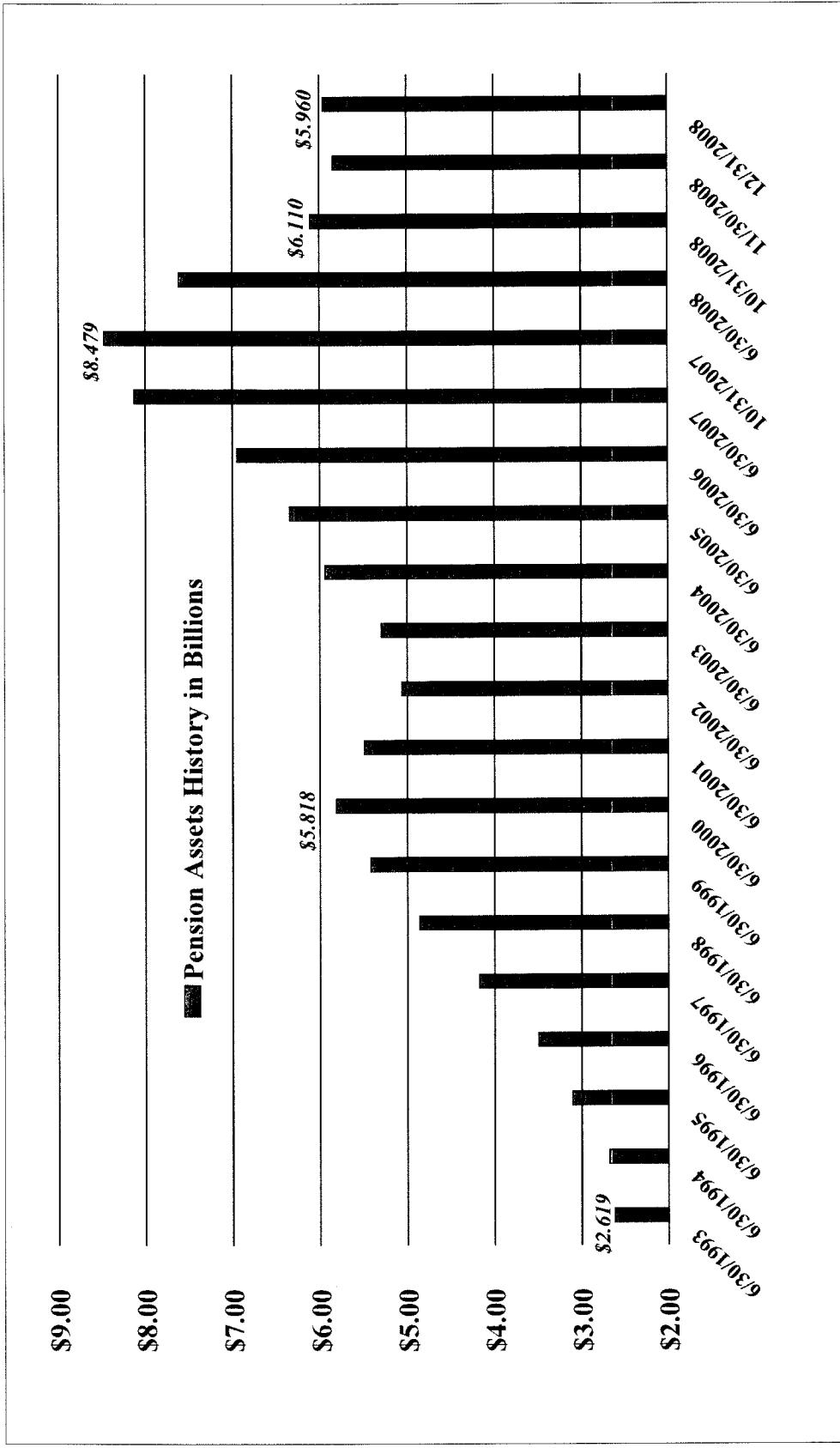
Range	Securities	Currency	Prc Appr	Daily Ret	Total Ret	Difference	Annual	Eq
1	S&P 1500 Composite Index		-32.23 %	-31.27 %	-10.13 %	-50.09 %		
2	MSCI ACWI xUSA		-42.06 %	-41.40 %		-62.85 %		
3								



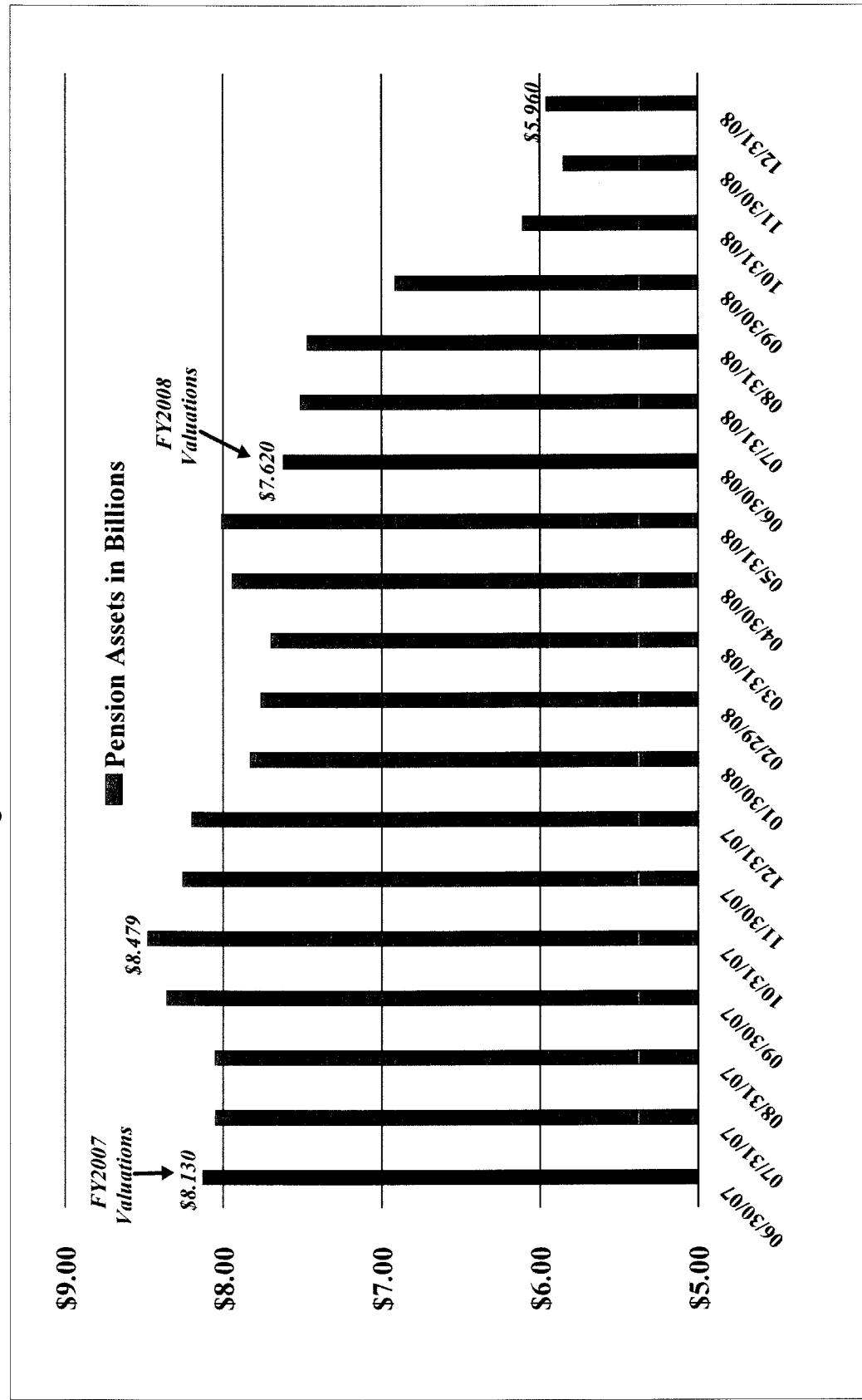
# Corporate Bond Spreads



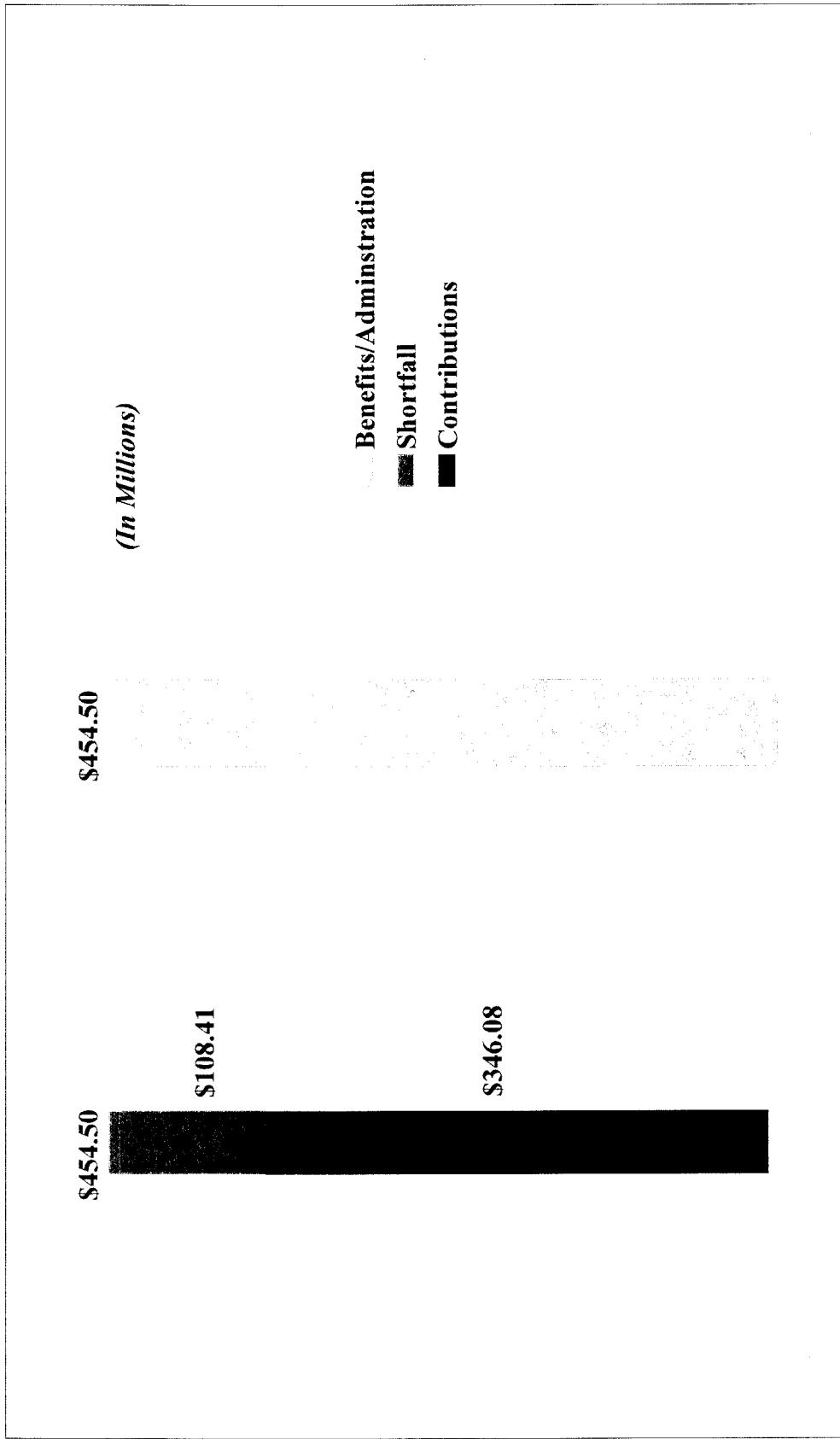
# Pension History at Fair Value



# Pension Values by Month

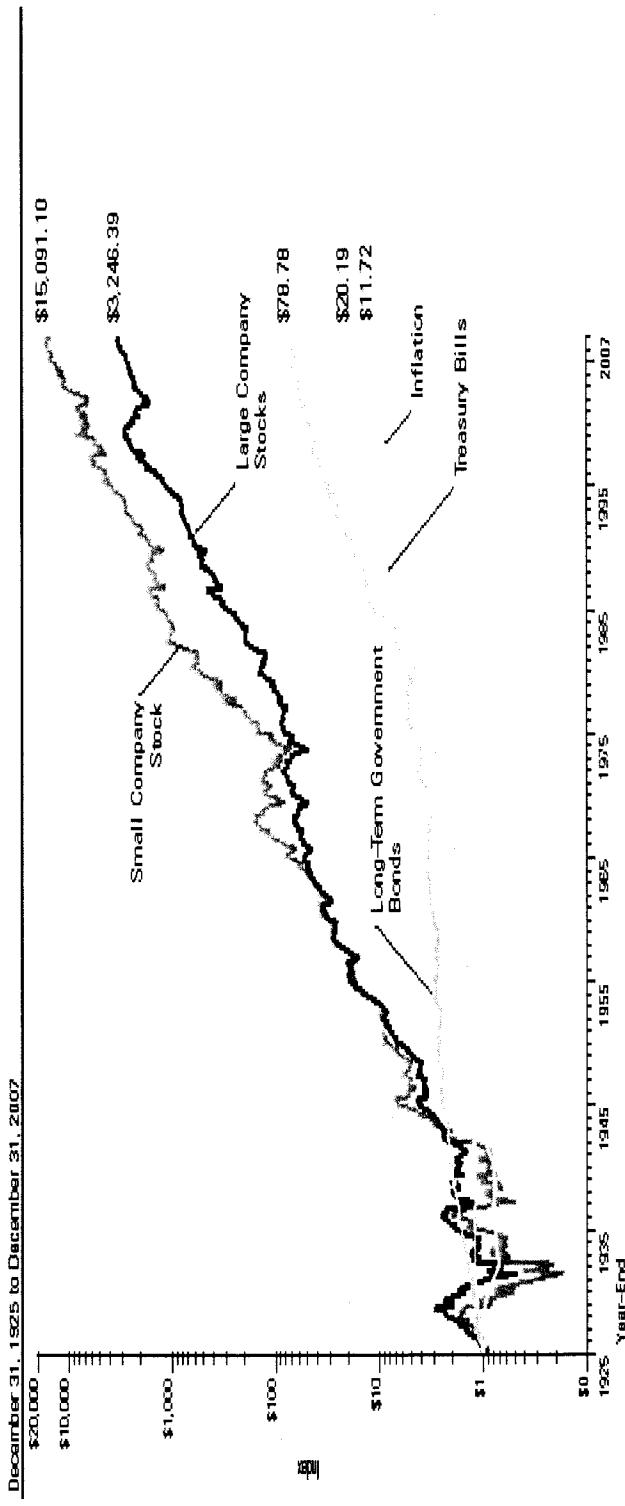


# Pension Fund Cash Flow



# Long Term Investment Returns

Graph 1  
Wealth Indices of Investments in the U.S. Capital Markets  
(Year end 1925 = \$1.00)



1B Stocks, Bonds, Bills, and Inflation

http://www.bogleheads.org/documents/reports/2007/2007.pdf

# Long Term Investment Returns

Table 7

**Basic Series and Portfolios: Summary Statistics of Annual Total Returns in Percent**

Market Report December 2007

Asset Class	1/1/26 to 12/31/07		
	Geometric Mean	Arithmetic Mean	Standard Deviation
<b>Large Company Stocks</b>	10.4	12.3	20.0
<b>Small Company Stocks</b>	12.5	17.1	32.6
<b>Long-Term Corporate Bonds</b>	5.9	6.2	8.4
<b>Long-Term Government Bonds</b>	5.5	5.8	9.2
<b>Intermediate-Term Government Bonds</b>	5.3	5.5	5.7
<b>U.S. Treasury Bills</b>	3.7	3.8	3.1
<b>Inflation</b>	3.0	3.1	4.2
<b>90% Stocks/10% Bonds</b>	10.1	11.6	18.0
<b>70% Stocks/30% Bonds</b>	9.3	10.3	14.5
<b>50% Stocks/50% Bonds</b>	8.4	9.0	11.4
<b>30% Stocks/70% Bonds</b>	7.3	7.7	9.3
<b>10% Stocks/90% Bonds</b>	6.1	6.5	8.7

Morningstar Data

# Allocations & Ranges Pre-Meltdown

**Allocations and Approved Ranges as of 09/30/07**

<u>Pension Fund</u>	<u>MDEP</u>	<u>MTIP</u>	<u>MPEP</u>	<u>Equity</u>	<u>RFBP</u>	<u>STIP</u>	<u>Mtg</u>	<u>Estate</u>	<u>Direct</u>	<u>Pooled</u>	<u>Real</u>	<u>Total Assets</u>
PUBLIC EMPLOYEES	41.9%	20.1%	8.0%	69.9%	23.8%	1.8%	0.8%	0.2%	3.4%	3.4%	4,203,115,739	
TEACHERS	42.4%	19.9%	7.8%	70.2%	23.8%	1.4%	0.9%	0.3%	3.5%	3.5%	3,259,175,625	
POLICE	41.0%	19.1%	7.7%	67.8%	24.1%	4.8%			3.3%	3.3%	215,218,721	
SHERIFFS	42.3%	19.4%	7.8%	69.4%	24.8%	2.4%			3.4%	3.4%	202,601,854	
FIREFIGHTERS	41.0%	19.1%	7.7%	67.8%	24.1%	4.7%			3.3%	3.3%	204,666,677	
HIGHWAY PATROL	41.8%	20.1%	8.0%	70.0%	24.9%	1.6%			3.5%	3.5%	105,280,677	
GAME WARDENS	41.8%	19.7%	7.9%	69.5%	24.4%	2.7%			3.4%	3.4%	76,190,660	
JUDGES	42.0%	19.7%	7.9%	69.6%	24.8%	2.1%			3.4%	3.4%	63,633,532	
VOL FIREFIGHTERS	42.3%	20.2%	8.0%	70.5%	23.7%	2.3%			3.5%	3.5%	27,889,006	
<b>TOTAL</b>	<b>42.0%</b>	<b>20.0%</b>	<b>7.9%</b>	<b>69.9%</b>	<b>23.9%</b>	<b>1.8%</b>	<b>0.8%</b>	<b>0.2%</b>	<b>3.4%</b>	<b>3.4%</b>	<b>8,357,772,490</b>	
<b>Approved Range</b>												
	30.0%	15.0%	5.0%	60.0%	22.0%	1.0%	0.0%	0.0%	0.0%	0.0%		
	50.0%	30.0%	10.0%	70.0%	32.0%	5.0%	4.0%	1.0%	8.0%	8.0%		

# Allocations & Ranges Post-Meltdown

**Allocations and Approved Ranges as of 12/31/08**

Pension Fund	MDEP	MTIP	MPEP	Equity	RFBP	STIP	Mtg	Direct	Pooled
	Total						Estate	Real	Real
<b>PUBLIC EMPLOYEES</b>									
PUBLIC EMPLOYEES	34.4%	14.6%	13.4%	62.4%	29.8%	0.5%	1.0%	0.3%	6.0%
TEACHERS	34.4%	14.6%	13.1%	62.1%	29.9%	0.6%	1.1%	0.4%	5.9%
POLICE	33.5%	14.6%	13.1%	61.2%	30.4%	2.5%			5.9%
SHERIFFS	33.8%	14.6%	13.2%	61.6%	30.9%	1.5%			5.9%
FIREFIGHTERS	34.5%	14.6%	13.4%	62.6%	30.8%	0.6%			6.0%
HIGHWAY PATROL	34.5%	14.7%	13.2%	62.4%	31.0%	0.7%			5.9%
GAME WARDENS	33.5%	14.6%	13.1%	61.2%	30.4%	2.5%			5.9%
JUDGES	34.0%	14.7%	13.3%	62.0%	31.0%	1.0%			5.9%
VOL FIREFIGHTERS	34.7%	14.6%	13.1%	62.4%	31.2%	0.6%			5.8%
<b>TOTAL</b>	<b>34.2%</b>	<b>14.6%</b>	<b>13.2%</b>	<b>62.0%</b>	<b>30.6%</b>	<b>1.2%</b>	<b>1.1%</b>	<b>0.3%</b>	<b>5.9%</b>
<b>Approved Range</b>									
	30.0%	15.0%	9.0%	60.0%	22.0%	1.0%	0.0%	0.0%	
	50.0%	30.0%	15.0%	70.0%	32.0%	5.0%	4.0%	1.0%	8.0%

# Pension Fund Investment Activity

## 2008 Retirement Funds Investment Activity

<u>Pool</u>	<u>Value of Units/ Purchased</u>	<u>Value of Units/ Sold</u>	<u>Net Transactions</u>
Retirement Funds Bond Pool (RFBP)	2,800,000	(6,958,243)	(4,158,243)
Montana Domestic Equity Pool (MDEP)	6,190,000	(14,934,944)	(8,744,944)
Montana International Equity Pool (MTIP)	5,255,000	(136,765)	5,118,235
Montana Private Equity Pool (MPEP)	63,120,000	-	63,120,000
Montana Real Estate Pool (MTRP)	161,500,000	-	161,500,000
<b>Total</b>	<b>238,865,000</b>	<b>(22,029,952)</b>	<b>216,835,048</b>

## 2007 Retirement Funds Investment Activity

<u>Pool</u>	<u>Value of Units/ Purchased</u>	<u>Value of Units/ Sold</u>	<u>Net Transactions</u>
Retirement Funds Bond Pool (RFBP)	109,670,000	-	109,670,000
Montana Domestic Equity Pool (MDEP)	9,699,997	(118,345,358)	(108,645,361)
Montana International Equity Pool (MTIP)	880,000	(172,551)	707,449
Montana Private Equity Pool (MPEP)	117,500,000	-	117,500,000
Montana Real Estate Pool (MTRP)	125,000,000	-	125,000,000
<b>Total</b>	<b>362,749,997</b>	<b>(118,517,909)</b>	<b>244,232,088</b>

# Pension Fund Investment Activity

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## 2009 YTD Retirement Funds Investment Activity

<u>Pool</u>	<u>Value of Units/ Purchased</u>	<u>Value of Units/ Sold</u>	<u>Net Transactions</u>
Retirement Funds Bond Pool (RFBP)		(108,130,000)	(108,130,000)
Montana Domestic Equity Pool (MDEP)		(5,440,000)	(5,440,000)
Montana International Equity Pool (MTIP)	43,085,000		43,085,000
Montana Private Equity Pool (MPEP)	112,530,000		112,530,000
Montana Real Estate Pool (MTRP)	43,880,000		43,880,000
 <b>Total</b>	 <b>199,495,000</b>	 <b>(113,570,000)</b>	 <b>85,925,000</b>



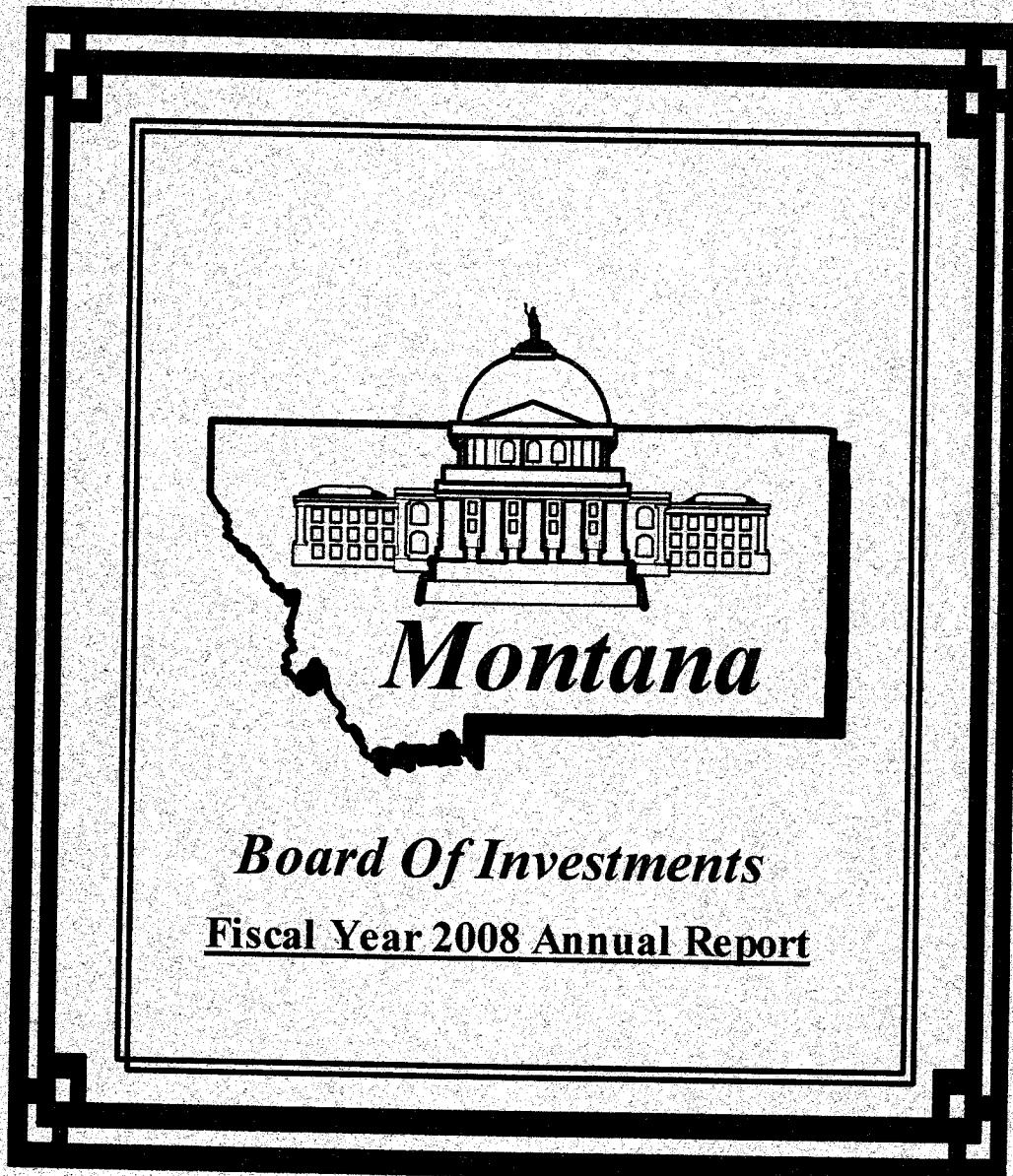
## **Exhibit 1**

**This exhibit is an over sized booklet which can not be scanned, therefore only the front cover and table of content have been scanned to aid in your research.**

**The original exhibits are on file at the Montana Historical Society and may be viewed there.**

**Montana Historical Society  
Archives  
225 N. Roberts  
Helena MT 59620-1201  
Phone (406) 444-4774  
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